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Supreme Court of the United States

OCTOBER TERM, 1942

Nos. 7 and 8

IN THE MATTER

of

WESTERN PACIFIC RAILROAD COMPANY,
a corporation.

FREDERICK H. ECKER, et al.

v.

WESTERN PACIFIC RAILROAD CORPORATION, et al.

CROCKER FIRST NATIONAL BANK, etc., et al.

v.

WESTERN PACIFIC RAILROAD CORPORATION, et al.

**BRIEF OF RESPONDENT,
IRVING TRUST COMPANY, AS REFUNDING
MORTGAGE TRUSTEE**

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Attorney for IRVING TRUST COMPANY,
as Successor Trustee under Debtor's
Refunding Mortgage.

ORRIN G. JUDD,
of Counsel.

Dated: October 3, 1942.



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BRIEF OF RESPONDENT,
IRVING TRUST COMPANY, AS REFUNDING
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Respondent, Irving Trust Company, is Trustee under
the Debtor's General and Refunding Mortgage dated as of
January 1, 1932, under which there are presently outstand-

ing \$18,999,500 principal amount (R. 1053) of bonds, all of which are pledged in varying amounts with three creditors of the Debtor, namely, A. C. James Co., Railroad Credit Corporation and Reconstruction Finance Corporation. Such mortgage is hereinafter called "Refunding Mortgage" and this respondent is hereinafter called "Refunding Mortgage Trustee".

The briefs of Frederick H. Ecker, et al., as Institutional Bondholders Committee, and of Crocker First National Bank et al., as Trustees under the Debtor's First Mortgage (Petitioners in Nos. 7 and 8) contain a number of statements respecting the properties subject to the lien of the Refunding Mortgage, which require answer in those proceedings.

Limitations of This Brief

The only points which we propose to answer in this brief are those which relate to the treatment to be given the Refunding Mortgage Creditors in respect of their lien on bonds and stock of Central California Traction Company, Alameda Belt Line and Tidewater Southern Railway Company. On all of these items the Refunding Mortgage is admittedly a first lien.

The questions of dispute concerning the priority of lien (relating to equipment-trust rolling stock, the Northern California Extension and non-carrier real estate) are treated in the Refunding Mortgage Trustee's brief as Petitioner in No. 61, and will not be repeated in this brief.

Cash and Securities on which Refunding Mortgage is Admittedly a First Lien

The Refunding Mortgage is *admittedly* a first lien on the following items:

Cash deposited with Refunding Mortgage Trustee as of January 1, 1939 (R. 1096).	\$ 223,732
Note of Tidewater Southern Railway Co., at face amount (R. 1095)	\$ 508,278
Stock of Tidewater Southern Railway Co., at par value (R. 1095)	\$1,147,955
Central California Traction Company securities (at book value to Western Pacific I. C. C. Ex. 82, p. 16):	
Bonds	\$270,000
Preferred Stock	264,715
Common Stock	128,952 \$ 663,667
Stock of Alameda Belt Line (at par value —I. C. C. Ex. 103)	\$ 465,300
Total	\$3,008,631.

The Refunding Mortgage Trustee urged in the District Court that the Tidewater Southern stock was worth more than its par value (R. 314)—which was the value used by the Commission—, since the Tidewater Southern had not only paid regular interest on its note but had demonstrated consistent ability to earn an average of \$100,000 a year (R. 1098), had furnished revenue to the Debtor of over \$500,000 a year on freight interchanged (R. 1098, 1308) and had built up a corporate surplus of over \$900,000 (R. 1097). For the purposes of this brief, however, the Refunding Mortgage Trustee does not dispute the value set forth above in respect of the Tidewater Southern stock, so that the question before this Court will relate primarily to whether the stocks and bonds of Central California Traction and Alameda Belt Line have any value.

The Reorganization Plan

Under the Commission's modified Plan of Reorganization, the Refunding Mortgage Bondholders were awarded new income mortgage bonds in the amount of \$732,010, which is the exact total of the cash on deposit with the Refunding Mortgage Trustee and the face amount of the Tidewater Southern note (R. 313). They were also awarded preferred stock in the amount of \$1,147,955, which is the exact par value of the Tidewater Southern stock (R. 313).

The Commission refused to award any securities in respect to the first lien on the Central California Traction or Alameda Belt Line bonds and stock on the ground that "the lien on the securities of these two companies has no material value" (R. 315). That is, it refused to award any new securities except insofar as the common stock allotted to the Refunding Mortgage creditors may have been based in part thereon.

Before the District Court, the Refunding Mortgage Trustee introduced additional evidence bearing on the value of these bonds and stock.

The Refunding Mortgage Trustee argued below that the Plan was unfair in refusing to award new senior securities in compensation for the first lien on the Central California Traction and Alameda Belt Line bonds and stock; and contended that the entire evidence before the Court required a finding that such bonds and stock had substantial value.

The Effect of the Circuit Court of Appeals Opinion

The opinion of the Circuit Court of Appeals requires the Commission to find "the value of (1) the property subject to the refunding mortgage only . . ." (R. 2670; 124 Fed. 2d at 139). The Refunding Mortgage Trustee believes that compliance with this instruction will result in

a determination that the Central California and Alameda Belt Line bonds and stock have substantial value, and that senior securities should be allocated to the Refunding Mortgage creditors in respect thereof.

The briefs to this Court on behalf of the Institutional Bondholders' Committee and the First Mortgage Trustees attempt to avoid the necessity of any such finding—the First Mortgage Trustees by supporting the Commission's statement that the lien on such securities has no value (Petitioner's brief in No. 8, pp. 25-26), and the Institutional Bondholders' Committee by arguing that the new income bonds and preferred stock issued to the Refunding Mortgage creditors constitute joint compensation for the Tidewater Southern securities and the other bonds and stock (Petitioner's brief in No. 7, pp. 102-03).

I

The income bonds and preferred stock awarded to the Refunding Mortgage creditors by the Commission represent compensation only for the cash deposited with the Trustee and the note and stock of Tidewater Southern.

The record is devoid of any support for the suggestion made by the Institutional Bondholders' Committee that the income bonds and preferred stock allocated to the Refunding Mortgage creditors were intended as compensation in part for the first lien on bonds and stock of Central California Traction Company and Alameda Belt Line.

The income bonds, as pointed out above, were exactly equal in face amount to the cash held by the Refunding Mortgage Trustee plus the face amount of the Tidewater Southern note. Surely cash and interest-paying notes are worth at least an equal amount of income-mortgage bonds. Therefore, none of such income bonds can be regarded as allocable to any other part of the property held by the Refunding Mortgage Trustee.

The preferred stock allocated to Refunding Mortgage creditors was exactly equal to the par value of the Tidewater Southern stock, and obviously was intended to be compensation only for that stock, and not for any other securities. The dividend requirements of such preferred stock are only \$57,000, against average earnings of Tidewater Southern exceeding its interest requirements by more than \$75,000 per year (R. 1098), without any consideration to Tidewater Southern's additional value as a feeder. Therefore, none of such preferred stock can be regarded as allocable to any other part of the property held by the Refunding Mortgage Trustee.

II

The evidence compels a finding that the bonds and stock of Central California Traction Company and Alameda Belt Line have substantial value.

The value of Central California Traction and Alameda Belt Line lies in the traffic which the Debtor derives from them, rather than in the earnings reflected on their books, but this in no way prevents such value from being real and substantial.

For the evidence bearing on such value, it is necessary to look to the testimony in the District Court as well as the evidence before the Commission. The right of all parties to offer additional evidence in the District Court is conceded (Petitioner's Brief in No. 7, pp. 20-21, 132; Bankruptcy Act, Section 77(e)). The Court, therefore, is not faced with a request to reverse the judgment of the Commission on the facts which were before the Commission, but simply with the question of the fairness of this phase of the Plan on consideration of all the facts in the record before the District Court.

Acquisition and Importance of Central California Traction Company

The Debtor's holdings in Central California Traction Company represent a one-third ownership in the Company, one of the remaining thirds being owned by Atchison, Topeka and Santa Fe Railway Company, and the other by Southern Pacific Company (R. 1042).

Ownership by the Debtor of an equal interest in Central California Traction Company is essential to protect its share of the traffic which originates and terminates on the Central California Traction lines. The Traction Company serves a very rich agricultural district (R. 1315). The Stipulation of Facts Not in Dispute states that the Traction Company has a value to the Debtor as a feeder and would be of value to any corporation which might succeed to its properties (R. 1102).

Mr. Elsey, chief operating officer for the Debtor's Trustees, stated to the Refunding Mortgage Trustee, in a letter which was written in 1937, after the close of the Commission hearings, and which was placed in evidence before the Court (R. 1247-63), some of the reasons why it was necessary to maintain the Debtor's equal interest in the Central California Traction Company.

This letter, designed to obtain the Refunding Mortgage Trustee's cooperation in action being taken by the other holders of the Traction Company's bonds, pointed out the difficulty the Debtor had undergone to obtain its interest in the Traction Company, and the continuing importance of preserving that pro-rata interest.

The circumstances of the Debtor's acquisition of its one-third interest in Central California Traction Company, as set forth in that letter, are extremely pertinent. Until 1927 the Traction Company had been operated as an independent electric freight and passenger railway. During 1925, however, Southern Pacific Company had made an agreement with the owner of the Traction Company to purchase all its

outstanding stock and the major portion of its First Mortgage Bonds. (All publicly-held bonds have since been retired.) When Southern Pacific Company applied for I. C. C. approval of this purchase, the Debtor and the Atchison, Topeka and Santa Fe Railway Company intervened to oppose. The Debtor felt that the matter was so serious that it filed an independent petition to construct a parallel line of railroad in the event the Traction Company ceased to be an independent line, free of control by any interstate railway company (R. 1251).

As a result of the objections by the Debtor and the Santa Fe, the Commission conditioned its permission to Southern Pacific Company to complete the purchase upon Southern Pacific's admitting the Debtor and the Santa Fe to participation equally with said Southern Pacific Company in joint control of Central California Traction Company, upon payment of proportionate shares in the cost of the securities to be acquired (R. 1251).

On the basis of these and other facts, Mr. Elsey stated to the Refunding Mortgage Trustee in such letter (R. 1262-63) :

"Parity has existed between the three parent companies from the beginning, and has been scrupulously maintained throughout the years of joint ownership. The United States District Court here which has jurisdiction of the Western Pacific reorganization proceeding made a special order permitting the Western Pacific Reorganization Trustees to make such advances and payments as might be necessary to protect Debtor's interest therein or to meet its contractual pro rata obligation as to Traction Company (and other affiliates with similar situation).

"It would *** be most unfortunate and establish a precedent with possibly far-reaching consequences to the future owner of the Western Pacific's Traction Company holdings—for one of the three owners to abandon its participation and parity in all Traction Company dealings—especially as the interest the Western Pacific and Santa Fe acquired in Traction

Company was solely because the Interstate Commerce Commission compelled the Southern Pacific to permit the participation."

The importance of the Traction Company as a source of traffic is shown by the fact that the Debtor's proportion of revenue from traffic interchanged with the Traction Company has averaged approximately \$225,000 a year (R. 1102-03), with virtually no falling off even during the depression. In 1939 such proportion of revenue was \$268,484 (R. 1311).

Although the Debtor has admittedly been compelled to contribute cash to the Traction Company in most of the years that the Company has operated (Petitioner's Brief in No. 7, p. 19), these contributions have been largely for capital purposes. The Company showed an average income for the five years 1934-1938 of \$11,775 (R. 1100) and for the year 1939 of \$30,452 (R. 1309). In only one year since 1933 has it shown an operating deficit (R. 1100).

The interest on the Central California Traction bonds pledged with the Refunding Mortgage Trustee has been paid regularly throughout the reorganization. The Stipulation of Facts Not in Dispute makes clear that the Debtor's Trustees "have considered it important that default not be permitted in the payment of interest on the outstanding bonds of the Traction Company or of the Debtor's share of other advances to the Traction Company" (R. 1102).

In the face of these facts, it is clearly unfair and improper to say that the lien on the Central California Traction bonds has no value. If the Debtor's Reorganization Trustees felt it important to maintain interest payments on the Central California Traction Bonds at a time when interest was not being paid on the Western Pacific First Mortgage bonds, the holders of the Central California Traction bonds should certainly receive in satisfaction of their lien on such bonds, at least an equal amount of income bonds of the new Company. They should also receive, in satisfaction of their lien on the stocks which represent a share in control of the Traction Company, preferred stock of the new Company.

having a par value at least equal to the book value of the Debtor's Traction Company stock. It may be noted that the book value of such stock on the books of the Traction Company (based on one-third of its stated value plus one-third of the corporate surplus) is \$890,862 (I. T. Co.'s Court Ex. 3; R. 1315), or substantially more than its book value on the Debtor's books, \$393,667 (I. C. C. Ex. 82, p. 16).

From the nature and circumstances of the property, it is certain that if the Refunding Mortgage were foreclosed and the securities of Central California Traction Company, which are pledged thereunder, were sold, the Refunding Mortgage Trustee could realize a substantial amount from such securities, either by sale to the other proprietary companies or even to outsiders. The Commission's Plan gives no consideration or allowance to this fact.

Importance of Alameda Belt Line to the Debtor

Half the outstanding stock of Alameda Belt Line is owned by Atchison, Topeka & Santa Fe Railway (R. 1103), and half by the Debtor.

The Belt Line furnishes the sole access for Western Pacific to the industrial district of Alameda (R. 1313), and the important Encinal Terminals and docks (R. 2087), which are a source of substantial traffic that might not be available except for the Debtor's participation in ownership of the Belt Line.

As its name implies, the Belt Line is merely a switching facility (R. 1313), and does not share in a division of line-haul rates. It has operated at a deficit which the Debtor has underwritten to the extent of approximately \$22,000 per year (R. 1105).

The value of the Belt Line to the Debtor is in the substantial amounts of traffic which it contributes, averaging 4800 carloads per year for the years 1935 to 1938 (R. 1105-06)—years before the war increased the importance of the Alameda docks and industries. Thus the Alameda Belt Line contributed between \$315,000 and \$331,000 per year to the Debtor's gross revenues (R. 1312-13), which would largely be lost if the Refunding Mortgage lien on the Belt Line were

foreclosed and the stock sold to someone other than the Western Pacific.

Lack of feeders was one of the factors which led to the first reorganization of the Western Pacific in 1916 (R. 1116). In view of the intense competitive situation on transcontinental freight, it is important for the Western Pacific to retain every feeder line in which it has an interest. The very fact that the Debtor's Trustees have felt it advisable to continue to meet their shares of the Belt Line's operating deficits during the period of reorganization shows that they consider it a valuable property. Its physical value, as fixed in Section 19-a proceedings, is over \$1,140,000 (R. 1314).

Mr. Elsey was asked at the hearing before the Court:

"Is it your best judgment that the benefit derived by the Debtor from retaining its participation in the Alameda Belt Line and the Central California Traction Company is greater than any loss through having to make advances to those companies?"

His answer was "Yes, sir" (R. 1315).

In view of this testimony, which was not in the Commission record, and in view of the facts concerning the Debtor's revenue on traffic derived from the Belt Line, which also were not in the Commission record, the conclusion that the lien on the Alameda Belt Line stock has no material value cannot be accepted as a fair basis for allocating new securities under the Plan.

III

The Refunding Mortgage creditors are entitled to senior securities of the new company in compensation for their lien on bonds and stock of Central California Traction and Alameda Belt Line.

As this Court stated in *Consolidated Rock Products Co. v. DuBois*, 312 U. S. 510, 528:

"Full compensatory provision must be made for the entire bundle of rights which the creditors surrender".

No provision has been made for compensation for the Refunding Mortgage creditors' surrender of their first lien on the Central California Traction and Alameda Belt Line bonds and stock. Yet the Refunding Mortgage creditors are being required (by release of the lien of the Refunding Mortgage—R. 394) to give up their right to have the Refunding Mortgage foreclosed and the Alameda Belt Line and Central California Traction bonds and stock sold thereunder.

The same principle which prompted the Interstate Commerce Commission to award income bonds and preferred stock (the same securities given to First Mortgage bondholders) in recognition of the Refunding Mortgage lien upon the Tidewater Southern note and stock (R. 315) requires that similar income bonds and preferred stock be awarded in recognition of the Refunding Mortgage lien upon the securities of Central California Traction Company and Alameda Belt Line.

Conclusion

This Court should direct that the Interstate Commerce Commission, when the case is referred back to it, award senior securities of the new company to the Refunding Mortgage creditors in exchange for their first lien on the bonds and stock of Central California Traction Company and Alameda Belt Line.

Dated: October 3, 1942.

Respectfully submitted,

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Refunding Mortgage.

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